31 T.C. 437 (1958)

A corporation that has undergone a change in ownership and business operations may still be entitled to carry forward net operating losses from its prior business activities, even if the new owners seek to offset those losses against profits from a different line of business.

Summary

British Motor Car Distributors, Ltd. (formerly Empire Home Equipment Co., Inc.) had incurred substantial net operating losses in its home appliance business. A partnership, engaged in the profitable business of selling foreign automobiles, acquired control of British Motor Car Distributors, Ltd., and transferred its assets to the corporation. The corporation then discontinued the home appliance business and began selling automobiles. It attempted to carry forward its prior operating losses to offset its new profits. The Commissioner disallowed the carryover, arguing that the change in ownership and business rendered the carryover impermissible under Section 129 of the Internal Revenue Code of 1939. The Tax Court held that the corporation was entitled to the loss carryover, distinguishing the case from the *Libson Shops* case and interpreting Section 129 to apply to the acquiring party, not the acquired corporation.

Facts

Empire Home Equipment Co., Inc. (Empire) was incorporated in 1948 and engaged in the wholesale and retail sale of home appliances. Empire incurred significant net operating losses in the fiscal years 1949, 1950, and 1951. By the end of 1951, Empire had liquidated its inventory, furniture, and fixtures, and sold its accounts receivable. The majority shareholder of Empire was a partnership which was in the profitable business of selling foreign automobiles. In September 1951, the partnership proposed to acquire certain stock of Empire, conditioned on Empire changing its name and increasing its authorized capital. On November 2, 1951, Empire changed its name to British Motor Car Distributors, Ltd. The partnership acquired the majority of the common stock of British Motor Car Distributors, Ltd., and transferred its assets to the corporation. British Motor Car Distributors, Ltd., then sought to carry forward the net operating losses from its appliance business against its profits from the automobile business.

Procedural History

The Commissioner of Internal Revenue disallowed British Motor Car Distributors, Ltd.’s, claimed carryover of net operating losses. The corporation then petitioned the United States Tax Court, challenging the Commissioner’s determination of deficiencies in income and excess profits tax for the fiscal years ending October 31, 1952, and October 31, 1953. The Tax Court reviewed the case based on stipulated facts.

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Issue(s)

1. Whether British Motor Car Distributors, Ltd., was entitled to carry forward the net operating losses sustained by Empire Home Equipment Co., Inc., against its income from the sale of automobiles and parts.

Holding

1. No, because the Tax Court held that British Motor Car Distributors, Ltd., was entitled to the loss carryover.

Court's Reasoning

The Tax Court addressed two main arguments by the Commissioner. First, the Commissioner argued that the corporation was not the same taxpayer as Empire and thus could not utilize the losses. The court distinguished the case from the *Libson Shops* case. The court pointed out that in *Libson Shops*, 16 separate corporations merged into one, while in this case there was a "single corporate taxpayer which changed the character of its business." The court emphasized footnote 9 of *Libson Shops*, which stated that the Supreme Court did not pass on situations where a single corporate taxpayer changed the character of its business. Second, the Commissioner contended that the allowance of the net operating loss deduction was prohibited by Section 129 of the Internal Revenue Code of 1939, arguing that the principal purpose of the acquisition was tax avoidance. The court disagreed, relying on its prior holdings in *Alprosa Watch Corp. v. Commissioner*, 11 T.C. 240 and subsequent cases, that Section 129 applies only to the acquiring corporation, not the acquired corporation. "That section would seem to prohibit the use of a deduction, credit, or allowance only by the acquiring person or corporation and not their use by the corporation whose control was acquired."

Practical Implications

This case provides an important clarification regarding the application of Section 129 of the 1939 Code. It suggests that a corporation can change its business and ownership structure without necessarily forfeiting its prior net operating losses, at least where the losses are sought to be carried forward by the acquired corporation. This ruling has significant practical implications for corporate acquisitions and restructuring, allowing corporations to plan for tax consequences by assessing how the change in ownership and business may or may not impact the use of net operating losses. The case also underscores the importance of distinguishing between acquiring and acquired corporations for purposes of applying Section 129. The holding in this case has been applied in many subsequent cases involving corporate acquisitions and loss carryovers.

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